No. 4068

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GENERAL STEAMSHIP CORPORATION (a corporation),

Appellant,

vs.

ASTORIA OVERSEAS CORPORATION (a corporation), OLOF ANDERSON, O. E. ANDERSON, O. B. SETTERS, T. L. GAUL, H. VANCE, LEE DRAKE, R. R. BARTLETT, and D. A. NYQUIST,

Appellees.

BRIEF FOR APPELLANT.

IRA S. LILLICK,
PLATT & PLATT,
MONTGOMERY & FALES,
Solicitors for Appellant.

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BRIEF FOR APPELLANT.

Statement of Case.

This is a suit in equity instituted by the appellant against the appellees to compel the stockholders of the Astoria Overseas Corporation to contribute the amount due upon their respective unpaid stock subscriptions in satisfaction of a judgment held by the appellant against the said corporation.

The existence of the judgment in favor of the appellant and the facts upon which the judgment was based are admitted by the answer of the appellees, but a brief review of these facts is essential

to a correct understanding of the issues involved in the present controversy.

On the 13th of September, 1922, a judgment was entered by the Circuit Court of the State of Oregon, for the County of Multnomah, in favor of a concern known as the A. M. Gillespie Company, and against the appellant and the Astoria Overseas Corporation, one of the appellees in this case.

The judgment covered the amount of a trade acceptance drawn by the appellant upon the Astoria Overseas Corporation and by the Astoria Overseas Corporation accepted.

The Astoria Overseas Corporation by virtue of its acceptance became primarily liable for the payment of the trade acceptance.

When the judgment was entered, however, the Astoria Overseas Corporation refused to pay the amount thereof and the appellant was compelled to satisfy the judgment.

Thereafter the appellant obtained an order of the Circuit Court of the State of Oregon for Multnomah County, directing the issuance of an execution in favor of the appellant and against the Astoria Overseas Corporation, which order was based on Section 243 of Olson's Oregon Laws.

After the issuance of an execution in favor of the appellant and against the Astoria Overseas Corporation the appellant was unable to find any assets of the Astoria Overseas Corporation out of which to satisfy the judgment and instituted the present

suit asking for a decree requiring the stockholders of the Astoria Overseas Corporation to pay into court the amount of their unpaid stock subscriptions in order that such money might be applied in satisfaction of the appellant's judgment.

All of the facts above set forth were admitted by the appellees upon the trial of this case.

These admissions established the right of the appellant to maintain the present suit as a judgment creditor of the Astoria Overseas Corporation.

It was also admitted upon the trial of this case that there existed certain unpaid stock subscriptions of the Astoria Overseas Corporation aggregating $24,692.50.

The judgment held by the appellant was for the sum of $4206.64, plus accruing interest.

The appellees offered by way of a defense to the claim of the plaintiff the following facts:

They asserted that during the month of July, 1921, prior to the entry of the judgment in favor of the appellant, the board of directors of the Astoria Overseas Corporation assigned to the Astoria National Bank the unpaid stock subscription list of the Astoria Overseas Corporation to secure a loan of $5000.00.

They also asserted that during the month of June, 1922, the Astoria Overseas Corporation ceased to function as a going concern, and that the board of directors of the Astoria Overseas Corporation assigned all its assets to O. B. Setters, as trustee, for

the purpose of liquidating the liabilities of the Astoria Overseas Corporation.

They also asserted that Mr. O. B. Setters, as trustee, reassigned all of such assets to the Astoria National Bank in trust for the creditors of the Astoria Overseas Corporation.

The second amended answer filed by the appellees showed, as above stated, that the unpaid stock subscriptions of the Astoria Overseas Corporation amounted to $24,692.50.

The same answer also showed that the liabilities of the Astoria Overseas Corporation amounted to $7414.98, plus an item of 13.56 pounds, English money, in favor of an additional concern.

These items are all set forth on page 23 of the Transcript of Record.

These same items are set forth in the testimony of Mr. O. B. Setters appearing upon pages 32 to 34, inclusive, of the Transcript of Record.

On page 34 of the Transcript of Record, Mr. Setters referred to some drafts called "Cohn Drafts," which he testified amounted to some nine thousand odd dollars, and also a claim of $900.00 in favor of the Astoria Flour Mills.

This makes a total liability of approximately $17,314.98.

It is a significant fact in this case that while the answer of the appellees claims that the Astoria Overseas Corporation was insolvent at the time of

making the last transfer referred to, that nevertheless the unpaid stock subscriptions exceeded the liabilities by at least $7000.00.

Over the objection of the appellant Mr. Setters was allowed to testify as to the number of creditors of the Astoria Overseas Corporation and also allowed to state as a conclusion that the stockholders of the Astoria Overseas Corporation were practically insolvent.

No direct evidence was introduced, however, by the appellees to show that any of them were insolvent.

It is also a significant fact that at the time when the board of directors of the Astoria Overseas Corporation conveyed to Mr. Setters all of the assets of the corporation, that Mr. Setters reconveyed the same to the Astoria National Bank, which bank was already a creditor of the Astoria Overseas Corporation.

It is also a significant fact that Mr. Stone, who was president and a director of the Astoria Overseas Corporation, was also a director of the Astoria National Bank.

See pages 35 and 36, Transcript of Record.

As before stated, the appellant is a judgment creditor of the Astoria Overseas Corporation and seeks to have the unpaid stock subscriptions of said corporation applied in satisfaction of its judgment owing to the absence of other tangible assets.

This claim is admitted by the appellees but they assert that the board of directors of the Astoria Overseas Corporation transferred to the Astoria National Bank these unpaid stock subscriptions as security for a loan and also assert that they transferred to the Astoria National Bank through the medium of O. B. Setters, all the assets of the Astoria Overseas Corporation.

Upon the trial of this case the appellant contested the validity of these defenses upon the following grounds:

It first asserted that the other creditors of the Astoria Overseas Corporation were not parties to the present litigation; that no effort had been made to make them parties; and that, therefore, their claims were no defense to the present suit.

It was also asserted by the appellant that the board of directors of the Astoria Overseas Corporation had no authority to convey to the Astoria National Bank the unpaid and uncalled stock subscriptions of the Astoria Overseas Corporation because such unpaid and uncalled stock subscriptions are not an assignable asset.

The evidence showed that no call had ever been made upon these unpaid stock subscriptions and until such call is made there is nothing which the board of directors can assign.

Furthermore, the only source of power to make such calls is the board of directors and the board of

directors cannot delegate the power to make such calls.

The appellant also contended upon the trial that the board of directors of the Astoria Overseas Corporation had no authority to assign all of its assets because under the decisions of the Supreme Court of the State of Oregon the stockholders of a corporation constitute the only body authorized to make such a transfer.

This latter rule is particularly applicable in a case where the record shows that the apparent assets of a corporation exceed its liabilities, because under such circumstances, in the absence of clear proof, a corporation cannot be deemed insolvent.

The appellant also contended upon the trial that Mr. O. B. Setters as trustee of the assets of the Astoria Overseas Corporation had no authority whatsoever to reassign such assets to the Astoria National Bank.

A trustee of a corporation for the benefit of its creditors certainly cannot defeat the trust by reconveying the trust property.

Furthermore, such a trustee could not defeat the trust by conveying the trust property to a creditor.

Such a transfer would certainly carry upon its face a strong presumption of fraud.

It should be remembered in the case at bar that the appellant labored under a very severe handicap.

The testimony of Mr. Setters shows that the Astoria fire destroyed practically all the records of the Astoria Overseas Corporation prior to the trial of this case, and the appellant therefore had little or no opportunity to examine or ascertain any record facts concerning the transactions between the Astoria Overseas Corporation and the Astoria National Bank or any of the other creditors of the Astoria Overseas Corporation.

It was compelled to rely upon a very meagre cross-examination of Mr. Setters, who simply testified from memory as to the transfers in controversy.

We contend, however, that this meagre testimony when viewed in the light of the established rules of law, discloses that the transfers relied upon as a defense to the present suit were invalid transfers.

The trial court in passing upon these issues virtually admitted the correctness of the legal propositions advanced by the appellant but denied to the appellant the benefit of the rules of law referred to by holding that the stockholders themselves had validated the invalid transfers by coming into court and setting up the validity of such transfers as a defense.

The decision of the trial court is set forth on pages 26-28 inclusive, of the Transcript of Record.

The effect of this decision is as follows:

A bona fide judgment creditor comes into a court of equity and asks to have the unpaid stock sub-

scriptions of the debtor corporation applied in satisfaction of his judgment.

The stockholders of such corporation appear and admit the existence of stock subscriptions more than sufficient to satisfy the judgment.

They assert, however, that their unpaid and uncalled for stock subscriptions have already been assigned by their board of directors.

The law says that such an assignment is in the first instance invalid.

But a court of equity says to this bona fide judgment creditor: It is true that the assignment was not good in the first instance but as long as the stockholders who are liable now consent to such assignment they can defeat your claim.

In other words, the stockholders of a corporation can defeat the rights of a bona fide creditor by merely setting up and ratifying an invalid act on the part of the board of directors of their corporation.

We will contend in this brief that such a rule contravenes the well established principles of equity which preclude any individual from setting up his own wrong or the wrong of his agent as a defense to a valid claim against him.

The decision of the trial court also applies the same principle in regard to the transfer of the assets of the Astoria Overseas Corporation to Mr. O. B. Setters and the Astoria National Bank.

It appears from the record in this case, as already stated, that the unpaid stock subscriptions exceed in amount all the liabilities of the corporation.

Under such circumstances the board of directors would have no authority whatsoever to transfer all of the assets of the corporation and thereby defeat the right of a bona fide creditor.

The decision of the trial court, however, holds that the stockholders themselves appeared in this case and ratified this unlawful act and that therefore the appellant should be precluded from maintaining the present suit and obtaining the satisfaction of a judgment which it has paid for the benefit of the defendant corporation.

The decision of the trial court does not discuss at all the invalidity of the transfer from Mr. Setters as trustee to the Astoria National Bank, the creditor, and apparently approved this latter transfer because in referring to the transfer of the assets of the corporation the court used the following language:

> "So likewise with the transfer of the assets of the corporation to Mr. Setter as trustee for the benefit of the creditors; that is also ratified and approved by the parties to this suit and I can conceive of no valid objection to it."
>
> Transcript of Record, pages 27 and 28.

The trial court also held that while the unpaid and uncalled for stock subscriptions could not be assigned by the directors, that nevertheless such

subscriptions could be assigned or their assignment consented to by the stockholders.

It may be true that the stockholders could assign an unpaid subscription which had been called for, because the call fixes and establishes the amount of the liability.

But we will contend that even the stockholders could not assign an uncalled subscription because the amount of the call could be determined only by the discretion of the board of directors.

The trial court in attempting to distinguish the rules of law advocated by the appellant entered an order directing the dismissal of this case, thereby holding that the appellant had no standing in a court of equity to obtain any portion of the unpaid stock subscriptions of the Astoria Overseas Corporation in satisfaction of a judgment which the appellant had paid for the benefit of such corporation.

We respectfully urge that the trial court was in error in so holding and as a basis for our contentions present the following specification of errors:

Specification of Errors.

I.

A judgment creditor may maintain a suit in equity against one or more of the stockholders of a corporation to have the unpaid balance due upon a stock subscription list applied in satisfaction of

his judgment, and this may be done without making other creditors parties.

Hatch v. Dana, 101 U. S. 205.

II.

Unpaid and uncalled for subscriptions cannot be sold and assigned or mortgaged by the corporation. When a call is necessary, then a corporation cannot assign the unpaid subscription.

Thompson on Corporations, Vol. 4, Sec. 3716;
14 *Corpus Juris,* page 638;
Silver Hook R. R. v. Greene, 12 R. I. 164, 165;
Coyote Mining Co. v. Ruble, 8 Ore. 285, 294;
Faull v. Alaska Gold Co., 14 Fed. 657, 660.

III.

An assignment for the benefit of creditors under the Oregon statute is void because such statute is superseded by the National Bankruptcy Act.

First National Bank v. Manassa, 80 Ore. 53, 58;
Pelton v. Sheridan, 74 Ore. 176.

IV.

A common law assignment requires the consent of all creditors.

Roesch v. Mumford, 230 Fed. 56, 59.

V.

Under the law of Oregon the stockholders of a corporation may by a vote of the majority of the stock authorize the dissolution of the corporation and the settling of its business, but such authority must come from the stockholders and this is the only source from which it can come.

Patterson v. Portland Smelting Works, 35 Ore. 96, 105;

In Re Quartz Gold Mining Co., 157 Fed. 243 (D. C. Or.);

Van Emon v. Veal, 158 Fed. 1022 (C. C. A. 9th Cir.).

VI.

A judgment creditor has a right to remove any obstacle to satisfy his execution at law or may reach assets equitable in their nature.

Pusey & Jones Co. v. Hanssen, decided by the Supreme Court of the United States April 9, 1923, and reported in Volume 67 Lawyer's Edition Advance Sheets, page 479.

VII.

A simple contract creditor of a corporation cannot have a receiver appointed in the Federal Court sitting in equity.

Pusey & Jones Co. v. Hanssen, decided by the Supreme Court of the United States April

9, 1923, and reported in Volume 67 Lawyer's Edition Advance Sheets, page 479.

Argument.

The issues presented by this case are very simple.

As already set forth in the opening statement, this is a suit by the appellant asking a court of equity to require the stockholders of the Astoria Overseas Corporation to pay into the treasury of the court the amount of the unpaid stock subscriptions of said corporation and also asking the court to apply such moneys to the satisfaction of the judgment which the appellant holds against said corporation.

The first question presented is whether or not the appellant has a legal right to maintain this suit. This question has been set at rest by the Supreme Court of the United States in *Hatch v. Dana,* 101 U. S. 205, already cited in our specification of errors.

The case referred to was a suit instituted by a judgment creditor of a corporation seeking to have the amounts of certain unpaid stock subscriptions applied in satisfaction of his judgment.

It was contended in the case that a creditor of an insolvent corporation was not at liberty to proceed against one or more delinquent subscribers to recover the amount of his debt without an account being taken of other indebtedness and without bringing in all the stockholders.

The Supreme Court of the United States in overruling this contention affirmed a decree of the trial

court awarding to the plaintiff a judgment against the defendant stockholders for the amount of their unpaid stock subscriptions to be applied in satisfaction of the plaintiff's judgment.

In the case at bar the appellees contend that the Astoria Overseas Corporation is insolvent.

We deny this contention and assert that from the face of the record the corporation is not insolvent.

But even considering the case from the standpoint of the appellee's contention, that the corporation is insolvent, nevertheless under the rule laid down in the case of *Hatch v. Dana,* above cited, the appellant would still be entitled to the judgment prayed for in his complaint.

In the case at bar the record admits that the appellant is a bona fide judgment creditor and also admits that there are sufficient unpaid stock subscriptions to more than satisfy the appellant's judgment.

We therefore respectfully contend that under the case of *Hatch v. Dana,* 101 U. S. 205, above cited, the appellant has a right to maintain the present proceeding and is entitled to a decree as prayed for in his complaint.

The only other issue presented upon this appeal is whether or not the appellees have interposed any defense sufficient to defeat the admitted claim of the appellant and the legal right to adopt the remedy invoked in the present case.

The first defense presented is that the board of directors assigned to the Astoria National Bank the unpaid stock subscriptions of the stockholders as security for a loan of $5,000.00.

It is admitted by the record in this case that this assignment was not authorized or directed by the stockholders of the corporation.

It is also admitted that the transfer of these unpaid and uncalled stock subscriptions was made by the board of directors of the Astoria Overseas Corporation.

We respectfully urge that neither the stockholders nor the board of directors could assign the unpaid and uncalled for stock subscriptions of the Astoria Overseas Corporation and that therefore such attempted assignment to the Astoria National Bank was void.

The rule in this particular is very accurately stated by *Thompson* in his work on Corporations in the following language:

> "It has been very generally laid down by the courts of both England and this country that unpaid and uncalled subscriptions cannot be sold and assigned or mortgaged by the corporation. When a call is necessary then a corporation cannot assign the unpaid subscriptions."
>
> *Thompson on Corporations,* Volume 4, Sec. 3716.

The same rule is also laid down in Corpus Juris in the following language:

> "A discretionary power vested in the directors to make calls, cannot be delegated by them unless they are authorized to do so by the charter or governing statutes."
>
> 14 *Corpus Juris,* 638.

There is nothing in the record in the present case to show any charter authority upon which the board of directors of the Astoria Overseas Corporation acted.

We have also examined the statutes of Oregon and fail to find any statute of the State of Oregon authorizing such action.

The same rule was also announced by Cook in his work on Corporations in the following language:

> "The unpaid and uncalled for subscriptions for stock cannot be mortgaged or sold by the corporation. If the transfer by the directors were allowed, the consequence would be that the discretion which they are bound to exercise would be wholly defeated and put an end to. The power of making calls being a discretionary one, cannot be transferred to other parties. The transfer is void."
>
> *Cook on Corporations,* Vol. 1, Sec. 111.

In *Fletcher's Cyclopedia, Corporations,* Vol. 2, page 1552, the rule is stated as follows:

> "By the weight of authority, in the absence of charter or statutory authority a corporation cannot pledge, mortgage or assign unpaid subscriptions when a call is necessary and has not been made, so as to entitle the pledgee, mortgagee or assignee to collect the same, for in such a case *the making of the call is dis-*

> *cretionary with the* directors or *stockholders,* and they cannot delegate the exercise of such discretion to another, unless expressly authorized to do so." (Citing both American and English cases.)

The same rule was also recognized by the Supreme Court of Rhode Island and in its decision the court used the following language giving the reason for the ruling.

> "The reason for the rule is based upon the well known rule of agency, sustained by the uniform current of authority, that the power conferred upon another to do an act which requires the exercise of judgment and discretion cannot be redelegated. The power conferred on the directors to make calls is of such a nature and cannot be redelegated by them."
>
> *Silver Hook R. R. v. Greene,* 12 R. I. 164, 165.

The record in the case at bar fails to disclose that any call was made upon the unpaid stock subscriptions of the Astoria Overseas Corporation at the time of the assignment to the Astoria National Bank.

The same record also affirmatively shows that no call has been made upon such subscriptions.

This appears from the testimony of Mr. Setters on page 32 of the Transcript of Record, wherein he states as follows:

> "That this litigation and other litigation came up and no effort has been made to make any collections on the stock subscriptions until the final result of the present suit."

We therefore respectfully urge that the alleged assignment of the unpaid stock subscriptions of the Astoria Overseas Corporation to the Astoria National Bank was as a proposition of law invalid and therefore cannot constitute a defense to the present suit.

The trial court held, however, that when the stockholders of the corporation appeared in this suit and alleged as a defense that such assignment of the unpaid stock subscriptions had been made, they thereby ratified the assignment and converted an invalid act into a valid act.

The fallacy of this decision is established by its mere statement.

This announcement overlooks the rule that not even the stockholders themselves could assign the unpaid stock subscriptions until a call had been made upon such subscriptions.

Until such call has been made no liability is established upon the part of the stockholder (in the absence of an express contract to the contrary) and there is no obligation in being, which is susceptible of assignment.

If the stockholders themselves could not in the first instance have made the assignment without having first made a call, then can it be logically contended that they can accomplish by ratification or by indirection that which they cannot accomplish directly.

Ratification implies that there is some act which can be ratified.

The stockholders of the Astoria Overseas Corporation could not ratify an absolutely void act of the board of directors.

Much less could they ratify an act which they themselves could not have done.

The most that the stockholders could do would be to adopt the action of the board of directors.

Such adoption, however, would date from the time of their appearance in the present case and this was long subsequent to the procurement of the judgment by the appellant.

Neither the stockholders nor the Astoria National Bank could convert the original void act into a valid act and have it relate back to the date of the act for the purpose of defeating the rights of the appellant, which is an innocent judgment creditor.

The directors could not assign the uncalled stock subscriptions.

The stockholders could not assign the uncalled stock subscriptions.

Therefore, there was nothing which the stockholders could adopt to the detriment of the appellant.

The most that could be claimed for such adoption by the appearance in this case would be that the stockholders themselves would be estopped as against

a subsequent creditor from setting up the void act of the board of directors as a defense.

Furthermore, to permit such a defense, in any event, should be contrary to the conscience of a court of equity.

The appellant in this case drew a sight draft upon the Astoria Overseas Corporation.

The Astoria Overseas Corporation accepted such draft.

By this act it made itself primarily liable for the payment of the obligation.

It refused to pay the obligation.

An action was then instituted against the corporation and a judgment obtained against the corporation as acceptor and against the appellant as drawer.

The drawer was then compelled to pay the judgment which had been obtained.

After it had paid the judgment it then called upon the Astoria Overseas Corporation for reimbursement.

Not a single stockholder of the corporation came forward and offered to contribute a penny to reimburse the appellant for the payment of this judgment.

Not a single effort was made by the Astoria Overseas Corporation or its stockholders to satisfy this judgment.

Mr. Stone, who is the president and director of the Astoria Overseas Corporation, and who was likewise a director of the Astoria National Bank, did not do a single thing to aid in the satisfaction of the judgment which the appellant had paid.

The appellant was then compelled to come into a court of equity and ask the aid of such court to obtain funds from the stockholders of the Astoria Overseas Corporation out of which to satisfy the judgment which it had paid.

Then at the eleventh hour, these very same stockholders come into court and assert that they should not be compelled to contribute anything toward this judgment because their agent, the board of directors of the Astoria Overseas Corporation, had already assigned some $24,000 worth of unpaid stock subscriptions to the Astoria National Bank to secure a loan for $5000.00, at a time when the Astoria Overseas Corporation had no existing liabilities.

This latter fact appears from the following statement of Mr. O. B. Setters on page 31 of the Transcript of Record:

> "That in July, 1921, it became necessary for the company to borrow $5000. That the company at that time had no other liabilities and its assets were the unpaid subscriptions of the stockholders of the corporation."

In other words, the stockholders of this corporation come into a court of equity and say to the appellant: It is true that you have paid a judg-

ment which the Astoria Overseas Corporation was primarily obligated to satisfy; it is true that you are a bona fide judgment creditor; it is true that there are some $24,000 worth of unpaid stock subscriptions of the Astoria Overseas Corporation; it is true that at the time when the Astoria Overseas Corporation had no other liabilities our board of directors, without making any call upon our stock subscriptions, assigned to the Astoria National Bank our $24,000 worth of subscriptions as security for a loan of $5,000; it is likewise true that after our board of directors made this assignment to the Astoria National Bank, they again assigned the same thing in the month of June, 1922, to Mr. O. B. Setters as trustee (see page 22, Transcript of Record); it is also true that Mr. Setters took those very same assets and reassigned them to the Astoria National Bank, the very concern to which the first assignment had been made; nevertheless, we say to you that you cannot compel us to contribute anything to the satisfaction of the judgment which you have paid because we now voluntarily affirm and ratify the invalid acts of our board of directors.

Should a court of equity give countenance to such a practice?

If the first assignment to the Astoria National Bank was a valid assignment, why was it necessary to make a second assignment?

If the first assignment to the Astoria National Bank was a valid assignment, how could the board

of directors of the Astoria Overseas Corporation then assign the same identical assets to a trustee for the benefit of creditors?

If the first assignment was a valid assignment, why should the Astoria National Bank want a trustee for the creditors of the corporation to reassign to it, in violation of his trust, the very thing which had been assigned to such bank in the first instance?

The second amended answer of the appellees states that the assets of the Astoria Overseas Corporation were reassigned by Mr. Setters to the Astoria National Bank, to be held in trust for the creditors of the Astoria Overseas Corporation.

See Paragraph 4, page 22, Transcript of Record.

How could the Astoria National Bank hold as trustee for the benefit of the creditors of the Astoria Overseas Corporation the very assets which it claimed to have received by a proper assignment as security for an advance which had been made?

When these questions are carefully considered and this entire record is examined, it seems to us that there exists a strong attempt on the part of the appellees in this case to manipulate in such a manner as to defeat the rights of a bona fide judgment creditor.

They say, first, that the only assets of the Astoria Overseas Corporation at the time of the assignment to the Astoria National Bank were the unpaid stock subscriptions of the corporation.

See page 31, Transcript of Record.

They say that at the time of the assignment to Mr. Setters as trustee and the reassignment to the Astoria National Bank that the only assets of the Astoria Overseas Corporation were the unpaid stock subscriptions.

See page 32, Transcript of Record.

In other words, they say you cannot compel us to pay in this case because we have given all of our assets to the Astoria National Bank as security for a loan.

They say in the second place that you cannot compel us to contribute anything in the present proceeding because we have assigned all of those assets to the same Astoria National Bank for the benefit of all our creditors.

They assert, in other words, that if we cannot defeat your claim by one defense, we will defeat it by another.

The trial court then says that even though the assignments might not have been valid in the first instance, nevertheless they were ratified by the appearance of the stockholders in this case.

Which assignment was ratified?

Was it the first assignment as security for the loan of $5,000 or was it the second assignment to the trustee for the benefit of creditors?

The decision of the trial court does not distinguish in this particular.

We have laid considerable stress upon the equities of the situation because it seems to us that the record in this case discloses a deliberate attempt to evade the obligation owing to the appellant.

In the first place we assert as a legal proposition that the assignment of the unpaid stock subscriptions by the board of directors of the Astoria Overseas Corporation was a void assignment because no call had been made upon such subscriptions.

We assert, in the second place, that the stockholders of a corporation cannot come into a court of equity and indirectly establish by ratification an act which they could not legally perform in the first instance.

We assert, in the third place, that the stockholders of a corporation should not be allowed to come into a court of equity and set up inconsistent positions for the purpose of defeating a bona fide judgment creditor.

We also assert that such stockholders should not be allowed to come into a court of equity and set up their own omissions, transgressions and the invalid acts of their own directors as a basis for defeating an honest claim.

He who comes into equity should come with clean hands and he certainly should not be permitted to attempt to wash his hands and present the unclean water as a defense.

The trial court apparently fell into error by failing to recognize in this case the distinction be-

tween stockholders, as individuals or as a body, and the corporation as entirely separate and distinct entities. It admits:

> "That the unpaid and uncalled-for subscriptions to the capital stock of a corporation cannot be sold or pledged by the corporation" (Transcript, page 27),

but claims that in the present case the mortgage transfer was ratified and approved by the stockholders appearing in court and insisting upon the validity of the transfer.

But if the corporation had no right to make the transfer, it cannot be held that the corporation would have the right, provided that it was done by the corporation through certain representatives. If the Astoria Overseas Corporation would not have the power to execute an assignment in its own name by the president, secretary or board of directors, how can it be held that the corporate powers are increased by merely executing the assignment in the name of the Astoria Overseas Corporation by the stockholders? In other words, if John Doe has not a lawful right to do a certain act himself, how can it reasonably be held that that act done by John Doe himself or by Richard Roe, his agent, is unlawful, but that the same act would be perfectly proper and lawful if done by John Doe through his agent Henry Smith?

Moreover, there was no action taken by the stockholders even purporting to act for the corporation in ratifying the mortgage transfer by the directors.

It certainly was not done at a stockholders' meeting, and the mere assent of the stockholders taken separately, and not at a stockholders' meeting, is not the will of the corporation, because the stockholders cannot separately and individually give their consent so as to bind the corporation. If an assent to certain acts affecting the corporation is obtained from the stockholders outside of a stockholders' meeting, or if an attempt is made to have the stockholders ratify any action of the board of directors by obtaining the ratification separately from each individual stockholder, written or otherwise, outside of a stockholders' meeting, the stockholders are deemed to be acting for themselves individually, and not as acting in any way for the corporation.

Pierce v. N. O. Building Co. (La.) 29 Amer. Dec. 448;

Clark v. Omaha Co., 5 Nebr. 314;

Duke v. Markham (S. C.) 10 S. E. 1017;

Langolf v. Seiberlich (Pa.) 2 Pars. Eq. Cas. 64;

Findley Leather Co. v. Kurtz, 34 Mich. 89 (Opinion by Chief Justice Cooley);

Hill v. Atlantic Company (S. C.) 55 S. E. 854;

Lawrence v. Montgomery Gas Co. (W. Va.) 106 S. E. 890.

In *Duke v. Markham* (supra), followed in *Hill v. Atlantic Company* (supra) the court quotes with approval from the case of *Liggett v. Banking Com-*

pany, 1 N. J. Eq., page 541, as follows (10 S. E. 1017 on page 1018):

> "The members of a corporation aggregate cannot separately and individually give their consent in such a manner as to oblige themselves as a collective body, for in such case it is not the body that acts; and this is no less the doctrine of the common, than of the Roman civil, law. 'Being lawfully assembled' says Ayliff, 'they represent but one person, and may consequently make contracts, and, by their collective assent, oblige themselves thereunto.' And, though all the members of a corporation covenanted on behalf of it under their private seals," this it was held, would only bind them personally, and not the corporation. Ang. & A. Corp. 232, which is supported by the numerous cases there cited. Again, in the same work, (Section 504:) "the separate action, individually, without consultation, although a majority in number should agree upon a certain act, would not be the act of the constituted body of men clothed with the corporate powers." Indeed, the authorities on this subject are numerous, uncontradicted, and supported by reason."

The most recent case on the point (May, 1921) is that of *Lawrence v. Montgomery Gas Co.* (supra). The following quotation is from the opinion of the court:

> "The law is well settled in this state as well as elsewhere that corporate action cannot be lawfully expressed or made binding by less than a quorum of the directors or stockholders acting jointly in a meeting thereof, regularly called after due notice as provided by law or By-law."

The court then quotes *Thompson on Corporations,* paragraph 3906, to the point that when they are not

consulting together as a board they are regarded as acting privately and unofficially.

In the present case there was not even an agreement between the stockholders to ratify the action of the directors, but there is merely the implied assent of those stockholders whose subscriptions were not fully paid up and named as defendants in this action. It does not even appear that such stockholders constitute a majority of the stockholders in the corporation. Such a ratification by the stockholders would, at the very most, indicate, only that the stockholders adopted as their own the action of the directors, who did not even pretend to be acting for the stockholders individually, and which would transfer to the bank merely their rights in their contract subscriptions with the corporation.

If a man enters into a contract with a corporation to buy a certain number of its shares of stock, and pays a part of the contract price, no doubt he has a right to assign to another his interests in the contract, that is, the right to pay the balance and receive the stock. But by no manner of means can that act be considered the act of the corporation, whether such an assignment is made by one stockholder or by all of the stockholders.

If, therefore, it can reasonably be held that one may ratify the act of another who did not act as the agent of the former, then the only interest which the bank acquired by the supposed ratification was the right to pay the balance due and re-

ceive from the corporation the certificates of stock as provided in the subscription contracts.

We respectfully urge that on this branch of the case the trial court was in error and that the decree should be reversed and a decree entered in favor of the appellant.

The second defense presented in this case is that all of the assets of the Astoria Overseas Corporation were transferred by the board of directors of the corporation to O. B. Setters, as trustee and by him reassigned to the Astoria National Bank.

It is asserted by way of conclusion in the answer of the appellees that in the latter part of May or the first of June, 1922, the corporation stopped functioning and that the board of directors conveyed all its assets, to wit, its unpaid stock subscriptions, for the benefit of its creditors.

There is no evidence in the case absolutely establishing that the corporation was insolvent.

On the contrary, the list of unpaid stock subscriptions and the list of liabilities introduced at the trial showed, as already pointed out, that the stock subscriptions exceeded the liabilities by approximately $7000.00.

The appellant objected to the introduction of this list of liabilities upon the ground that the other creditors were not parties to this suit, but this objection was overruled and Mr. Setters was allowed to testify that most of the stockholders were insolvent.

Not a single effort was made by any of the stockholders to show their insolvency and we contend that from the face of the record the insolvency of the Astoria Overseas Corporation is negatived by its own statement of assets and liabilities.

Under such circumstances the board of directors certainly had no authority to convey all of these assets to Mr. Setters as trustee.

The rule of law applicable in this particular was announced by the Supreme Court of Oregon in the following language:

> "A private corporation, organized under the law of this state, may, at any meeting of the stockholders called for that purpose, by a vote of a majority of the stock, authorize the dissolution of such corporation, the settling of its business, and the disposing of its property; Hill's Annotated Laws, Section 3235. The statute having prescribed the source from which emmanates the authority for winding up the affairs of the corporation and liquidating its debts, the origin thus provided is exclusive."
>
> *Patterson v. Portland Smelting Works,* 35 Ore. 96, 105.

The rule last referred to was cited with approval by the District Court for the District of Oregon, in the case of *Quartz Gold Mining Co.,* 157 Fed. 243, which case was affirmed by the Circuit Court of Appeals of the Ninth Circuit, 158 Fed. 1022.

In the case last cited an insolvent corporation endeavored through its board of directors to commit an act of bankruptcy.

Judge Wolverton held that under the Oregon statute the board of directors of even an insolvent corporation could not commit an act of bankruptcy.

In passing upon the question the court used the following significant language:

> "Under the Oregon statute, at the first meeting of the stockholders and the election of directors, the powers vested in the corporation are to be exercised by such directors. * * * The powers thus accorded must be to conduct and carry out the business designated and specified in the articles of incorporation. The directors could have none other, unless specifically conferred. It is not an ordinary power pertaining to the board to dissolve the corporation, or to wind out its business; and the Legislature of the state has declared that the stockholders may do these acts. So that, under the statute, the directors are without any power whatsoever in the premises. If they cannot authorize dissolution and a winding out of the business of the corporation, it would seem to logically follow that they could not, in behalf of and as the act of the corporation, commit an act of bankruptcy which entails an entire disposition of the assets of the concern and a full settlement of all its past business transactions, unless by some authority of the stockholders, through appropriate by-laws or specific resolutions empowering them to so act."

In re Quartz Gold Mining Co., 157 Fed. 243, 246.

The decision last cited was adopted as the decision of the Circuit Court of Appeals for the Ninth Circuit, 158 Fed. 1022.

Under the decision of Judge Wolverton last cited, it was virtually held that not even the directors of an insolvent corporation could convey all of its assets without the authority of its stockholders. And what has been said heretofore in reference to the supposed ratification by the stockholders of the mortgage transfer to the bank applies equally as well to the supposed ratification by them of the assignment to Setters.

In the case at bar, therefore it is immaterial for the purpose of this discussion whether the Astoria Overseas Corporation was solvent or insolvent.

We therefore respectfully urge that the alleged assignment by the directors of the Astoria Overseas Corporation to O. B. Setters as trustee of all the assets of said corporation was an invalid assignment because not authorized by a majority of the stockholders of the corporation, nor at a stockholders' meeting.

It should be remembered, also, in this connection that the thing which was assigned to Mr. O. B. Setters was the subscription list of uncalled stock subscriptions and the authorities which we have already cited hold that not even the stockholders can assign an uncalled stock subscription list.

We also assert that if the stockholders could not in the first instance have assigned an uncalled stock subscription list then certainly they could not cure by ratification the thing which they could not do in the first instance, because until the call was made there was nothing to assign.

The same observations regarding the equities of the case which are applicable to the first assignment, likewise apply to the second assignment.

Should the stockholders of the Astoria Overseas Corporation be permitted to come into a court of equity and defeat the rights of an innocent bona fide judgment creditor by setting up and attempting to ratify an invalid act.

The doctrine of ratification might apply as against the stockholders themselves but certainly should not apply as against an innocent judgment creditor.

Furthermore, we have the same incongruity, already pointed out, in connection with the first assignment.

At the time of the first assignment the only assets of the corporation were the uncalled for stock subscriptions.

These were attempted to be assigned to the Astoria National Bank.

At the time of the second assignment the only assets of the corporation were the uncalled for

stock subscriptions and an attempt was made to assign these to Mr. Setters for the benefit of the creditors and Mr. Setters in direct violation of his trust attempted to assign those very uncalled for stock subscriptions to the Astoria National Bank for the benefit of all the creditors.

This second contention on the part of the appellees again emphasizes the absolute incongruity of the defense.

If as the trial court held, the stockholders had ratified both of these assignments, and have thereby injected life into them, then where are the unpaid stock subscriptions at the present time?

Are they in the hands of the Astoria National Bank by virtue of the first assignment or are they in the hands of the Astoria National Bank by virtue of the second assignment?

In the first instance it is claimed that the bank holds them as security for a loan.

In the second instance it is contended that the bank holds them as assets for the benefit of the creditors of the Astoria Overseas Corporation.

How can the Astoria National Bank occupy two such incongruous positions, and yet the decision of the trial court specifically and separately validates both of these assignments. We again revert to the inconsistency in this particular in order to emphasize the inequitable position asserted by the stockholders and appellees in this case and to show how

the said stockholders are attempting by every hook and crook to evade the legitimate claim asserted by the appellant in this case.

In addition to all of the above we contend that the assignment to Mr. Setters as trustee was invalid because there is no evidence showing that the consent of all the creditors was obtained.

It has been held by the Supreme Court of the State of Oregon that the statutory provisions of the State of Oregon governing assignments for the benefit of creditors have been suspended by the National Bankruptcy Act and are therefore void.

This rule was laid down in the case of *First National Bank of Manassa,* 80 Or. 57.

It must therefore follow that the assignment alleged in the answer of the Astoria Overseas Corporation was a common law assignment.

Such a common law assignment would necessitate the consent of all creditors.

This rule was laid down by the Circuit Court of Appeals for the Third Circuit in the following language:

> "This conveyance grew out of Shinn's insolvency and was suggested by his anxiety to conserve his property for the benefit of all his creditors. For some reason he did not choose to pursue the course provided by the Federal Bankruptcy Act or the one open to him under the general Assignment Act of the State of New Jersey. * * * If he had adopted either of these courses the rights of all creditors would

> have been fixed by law. As he pursued neither this acceptance by his creditors for the remittance they already had, of course, had to be obtained."
>
> *Roesch v. Mumford,* 237 Fed. 56, 59.

The next contention urged by the answer of the appellees is that they as stockholders are entitled to have a receiver appointed for the benefit of all the creditors of the Astoria Overseas Corporation.

The trial court did not pass upon this question because by the dismissal of the case such question was eliminated.

This question, however, has been set at rest by the Supreme Court of the United States in the recent case of *Pusy & Jones v. Hanssen,* decided April 9, 1923, Volume 67, Lawyer's Edition Advance Sheets, page 479.

In the case last cited the Supreme Court held that a simple contract creditor could not have a receiver appointed in a federal court sitting in equity.

Certainly a stockholder could have no greater rights in such particular than a creditor.

The same case further held that state statutes governing the appointment of receivers had no effect in a federal court of equity.

Therefore, the claim of the appellees for the appointment of a receiver should be denied.

While the appellant's case is based upon the foregoing rules, we think it not improper to call

the court's attention to the further point that the trial court inadvertently placed the appellant in a situation whereby it is likely, in the future, to be cut off from certain benefits given to it under the rules in equity, and at the same time will give the appellees a most unconscionable advantage. If the decision of the trial court is allowed to stand it will deny forever all hope of reimbursement for funds expended by appellant in behalf of appellees and in payment of a debt for which the appellees were liable.

The trial court held that, as the stockholders had, by their defense to the action, consented to the mortgage transfer of the unpaid stock subscriptions to the bank, the appellant had no claim whatever against the fund for unpaid stock subscriptions. This necessarily follows from the fact that the whole purpose of the appellant's action and the prayer of its complaint was to subject those unpaid stock subscriptions to the appellant's claim, and after a hearing in full, the complaint was dismissed and a decree ordered in favor of the appellees.

No doubt it was the right of the appellees to assume the risk of an adverse decision if they chose, in not making the bank a party to the action. In such a case they might subsequently have to defend a suit brought against them by the bank, and be compelled to litigate the same issue, that is the validity of the mortgage transfer of the unpaid stock subscriptions to the bank. But that was the

appellees' option, and the exercise of it can in no way affect the appellant's rights. The issue in this case is whether, as between appellant and appellees, the former is entitled to the unpaid subscriptions or any part thereof. If the mortgage transfer to the bank was invalid, then the appellant is entitled to all of the unpaid subscriptions. If it was valid, as the lower court held, then the indebtedness by appellees to appellant being admitted, the latter is entitled to whatever interests the appellees had in that fund; namely, the total unpaid subscriptions, subject to whatever interests the bank may have in that fund.

If we assume, for the purpose of argument only, that the mortgage transfer of the unpaid stock subscriptions to the bank was valid, that would place the parties in this situation: the common debtors are the appellees; one creditor, the bank, has two sources of liabilities from which its claim might be paid; first, the personal liability of the directors who signed the note to the bank jointly with the Astoria Overseas Corporation, as makers (Transcript, page 31), and second, the personal liability of the stockholders on the unpaid subscriptions. The appellant, however, can be paid only from one source of liability, that is, the unpaid stock subscriptions. Such a case clearly calls for the application of that general principle of equity that if one party has a right to be paid from two funds for a debt, and another party has a right to be paid from one only of the funds for another debt, the latter has a right in equity to compel the former to

resort to the other fund in the first instance for satisfaction, if that course is necessary for satisfaction of the claims of both parties.

Russel v. Howard, Fed. Cas. No. 12,156;
Merchants National Bank v. McLaughlin, 2 Fed. 128;
Covington National Bank v. Commercial Bank, 65 Fed. 547;
Matthews v. Memphis Railroad Company, 108 U. S. 368, 27 L. Ed. 7567.

In the United States Supreme Court case last above cited the facts were that one John Scruggs entered into a contract with the railroad company by which he agreed to erect on the railroad company's land a railroad hotel and to pay the railroad company an annual rent of $250. The railroad company reserved the right under the contract to take possession of the hotel and pay Scruggs its value. Scruggs also reserved the right to surrender the hotel to the railroad company, and require the company to pay him its value. Thereafter Scruggs erected the hotel, and conveyed it to his wife, together with his leasehold interest in the railroad company's land. On the same day Mrs. Scruggs agreed with the railroad company that the lease of the land and the property thereon should be surrendered to the railroad company. The amount to be paid to Mrs. Scruggs by the railroad company was submitted to arbitration, and an award was given to Mrs. Scruggs. The railroad company re-

fused to pay the award, or take possession of the property, during which time Mrs. Scruggs received the income from the property. It further appeared that Mrs. Scruggs had, during the life of the leasehold interest, executed to one Viser a mortgage upon the leasehold and improvements thereon. It was held that this mortgage gave Viser a lien on the income of the property covered thereby. Thus it appeared that the railroad company could satisfy its claim against Mrs. Scruggs out of either of two funds, that is, the amount due to Mrs. Scruggs by the railroad company, or the income received by Mrs. Scruggs, who was insolvent, from the property. Viser, on the other hand, had a lien against only one fund, that is, the income from the property. The court applied the above equitable doctrine, and held that Viser's claim should be satisfied out of the income of the property which was represented by a fund deposited in court. The court said:

> "There were then two funds, the principal and the interest of the decree (note: in favor of Mrs. Scruggs against the railroad company for the value of the improvements). Viser had a lien on the interest, and the demand of the railroad company was payable out of their principal or interest. Following, therefore, the practice of Courts of Equity in marshaling securities, Aldrich v. Cooper, 8 Ves. 382, the court directed the payment of Viser's lien out of the interest."

Of course, no such order could be made in the present case, because the bank is not a party to this action. But supposing the decision of the lower

court is allowed to stand, and the appellant brings another action against the appellees and makes the bank a party respondent also, in order to marshal the debtor's assets, providing, of course, it established the right to them. Exactly the same issue would be involved in such a case as was litigated in the present action; namely, the appellant's right to have applied to its debt the unpaid stock subscriptions. The issue in reference to the right to marshal the assets of the debtor would be only incidentally involved, in that it is merely a means to apply the unpaid subscriptions to the appellant's debt, in the event that appellant could show that it was entitled to them. In fact, the complaint in such a subsequent action would be exactly like the complaint filed in the present action, with the additional allegations affecting only the additional respondent, the bank.

The parties would be the same, the addition of another party respondent would in no way affect the case between appellant and appellees. In short. there would not be one single bar to the plea of *res judicata* by appellees in a subsequent action brought by appellant, and, as it has been already adjudged that the appellant has no cause of action against the debtors, the appellees, for the unpaid subscriptions, there could not, of course, be any relief against the bank in marshaling the assets of the debtors.

Again, supposing the bank collects the full amount due on the unpaid stock subscriptions, de-

ducts the amount of its loan, and has a balance left of approximately $19,000 which it holds for the benefit of the appellees. Under the decision of the trial court, that appellant is not entitled to have the unpaid stock subscriptions applied on appellees' indebtedness to it; the creditor, the appellant, is placed in a most exasperating position, and a great injustice is done. Here are the debtors, admitting the debt, and with funds about to be turned over to them as their own. Yet the court would be bound to confess its helplessness to order that the balance of the fund be paid over to the creditor, or to assist the creditor in any way, solely because of the existing decision that the appellant is not entitled to the unpaid stock subscriptions or any part thereof.

If the trial court believed that the mortgage transfer to the bank was valid, it should have held that the appellant was at least entitled to the appellees' equity in the unpaid stock subscriptions, that is, the total amount of such unpaid subscriptions subject to the claims of the bank. The bank could then have been brought in by supplemental proceedings and the priorities to the fund determined as between the appellant and the bank.

Our position here, however, is that the mortgage transfer of the unpaid stock subscriptions to the bank is invalid, and if the court agrees with us upon that point it will be unnecessary to consider this phase of the case.

In conclusion, we assert the following propositions:

I.

The appellant as a judgment creditor is entitled to maintain the present suit and have the unpaid stock subscriptions of the Astoria Overseas Corporation applied in satisfaction of its judgment.

II.

The assignment of the uncalled stock subscription list to the Astoria National Bank by the board of directors of the Astoria Overseas Corporation was in contemplation of law an invalid assignment because an uncalled subscription cannot be assigned.

III.

The assignment of all the assets of the Astoria Overseas Corporation by the board of directors of the Astoria Overseas Corporation was an invalid assignment because made without the consent or authority of the stockholders.

IV.

The stockholders of the Astoria Overseas Corporation could not by appearance in the present case ratify the assignment of the uncalled stock subscriptions to the Astoria National Bank because such uncalled subscriptions are not an assignable asset.

V.

The act of the board of directors in assigning all the assets of the Astoria Overseas Corporation to

O. B. Setters as trustee could not be ratified by the stockholders of the corporation because the corporation was not in an insolvent condition and because the consent of all the creditors to such an assignment was necessary.

VI.

The stockholders of the Astoria Overseas Corporation should be in equity estopped from attempting to defeat the claim of the appellant by asserting in one breath that they ratified the action of their board of directors in assigning their uncalled subscriptions to the Astoria National Bank, and then asserting in the next breath that they ratified the assignment of their uncalled stock subscriptions to O. B. Setters as trustee for the benefit of creditors, and in turn ratified the breach of trust by Mr. Setters in conveying such assets to the Astoria National Bank, which bank claims to have already held those very assets as security for a loan.

The defenses interposed by the appellees in this case violate well established principles of law; contravene the soundest principles of morals and equity; bear strongly the impress of evasion and fraud; and attempt to defeat by evasion, rather than to openly defend, the legitimate claim of a judgment creditor which has paid out a large sum of money on an obligation for which the Astoria Overseas Corporation and its assets are primarily liable.

For the reasons presented we respectfully urge that the decree of the trial court should be reversed

and a decree entered in favor of the appellant in this case.

Respectfully submitted,

IRA S. LILLICK,
PLATT & PLATT,
MONTGOMERY & FALES,
Solicitors for Appellant.